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Central Intelligence Agency



Washington, D.C. 20505



Iran Iraq War

13 September 1985

MEMORANDUM FOR: VADM John M. Poindexter, USN
Deputy Assistant to the President for
National Security Affairs

The Honorable Michael B. Armacost
Under Secretary of State for Political Affairs

The Honorable Fred C. Ikle
Under Secretary of Defense for Policy

(b)(1)
(b)(3)


The Honorable Richard L. Armitage
Assistant Secretary of Defense
for International Security Affairs

VADM Arthur S. Moreau, Jr., USN
Assistant to the Chairman,
Joint Chiefs of Staff

Mr. Rod McDaniel
National Security Council

SUBJECT : Impact of a Persian Gulf Oil Cutoff

The NSC Staff has asked us to circulate the attached paper prior to Monday's CPFG meeting.


Robert M. Gates
Deputy Director for Intelligence

Attachment:
Impact of a Persian Gulf Oil Cutoff

APPROVED FOR RELEASE
DATE: AUG 2002

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Washington, D.C. 20505



DIRECTORATE OF INTELLIGENCE

12 September 1985

Impact of a Persian Gulf Oil Cutoff

Summary

With Free World surplus capacity now running at about 11 million b/d--almost half of which is in Saudi Arabia--the market could easily absorb a loss of exports from Iran, Iraq and Kuwait. A serious problem would arise if Saudi exports were also cut or if all oil shipping in the Persian Gulf were stopped. Although our imports from Persian Gulf countries are small, the United States has a large stake in the continued flow of oil from the region since we could not insulate ourselves from a major oil disruption. The United States would share the burden of any net supply shortfall as oil prices rose and oil companies diverted supplies in response to market pressures. In the event of a major disruption, oil supplies might be allocated based on the International Energy Agency (IEA) sharing agreement which could mean significant diversion of oil from the US market to Western Europe and Japan. [redacted]

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Impact of a Persian Gulf Oil Cutoff

Current Situation

The current combination of substantial excess production capacity and weak demand provides considerable protection against an oil supply cutoff. Current available surplus capacity that could offset a supply cutback stands at about 11 million b/d, but only some 3 million b/d of that surplus is outside the Persian Gulf.

Weak market conditions have caused oil companies to reduce oil stocks. We estimate non-Communist oil stocks at mid-year stood at roughly 4.0 billion barrels or some 85 days of supply.


- o Most of current stocks represent minimum operating requirements needed to ensure smooth functioning of the distribution system, compulsory stocks that companies maintain to meet government regulations and government owned stocks. We estimate that useable commercial inventories total only about 100-200 million barrels or 2 to 4 days of consumption. This stock cushion has declined from about 20-25 days in the early 1980s and now provides only small hedge against oil supply cutoffs.
- o Sizeable government-owned stocks are located only in the United States (486 million barrels), Japan (110 million barrels) and West Germany (55 million barrels). In July 1984 IEA members agreed to coordinate stock drawdowns and/or take "complementary action" (demand restraint) to share the burden of any economic dislocations in future oil disruptions.

Western Dependence on Persian Gulf Oil

Persian Gulf countries are now exporting about 7.5 million b/d, accounting for about one-fifth of total non-Communist oil supplies. Of this, some 6 million b/d flow through the Strait of Hormuz with the remainder shipped via pipelines from Saudi Arabia and Iraq to the Mediterranean and the Red Sea. In first-quarter 1985, Western Europe, Japan, and the United States relied on the region for about 18 percent, 58 percent, and 4 percent, respectively, of their total oil imports. Although Western Europe's reliance on the region has declined in recent years, several countries remain heavily dependent on Persian Gulf oil. Italy, Greece, Portugal, and Turkey received from 33 to 80 percent of their oil supplies from the region during first quarter 1985.

Vulnerability of Persian Gulf Oil Facilities

Although crude oil is now beginning to flow from Iraq through the spur to Saudi Arabia's East-West pipeline, the well



defended pumpstations along the Iraq-Turkey pipeline remain the most critical chokepoints for Iranian attack followed by the crude processing plants at Kirkuk which serve Iraq's northern oilfields. Elsewhere in the Gulf, the most critical and vulnerable oil targets are the export-loading facilities. Saudi Arabia's facilities at Ras Tanura and Ju'aymah are vulnerable to both air attack and commando raids, as are Kuwait's Mina al Ahmadi onshore export terminal and Sea Island. If key components of these facilities were damaged, it could take more than three months to reopen them even partially; repairing major structural damage could take a year.

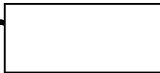
Impact of Oil Disruptions

The impact of a disruption of Persian Gulf oil exports in the near term would depend mainly on its severity and duration, the availability of supplies from other producers and the use of petroleum stockpiles. The oil market could easily absorb a loss of Iranian oil exports. Surplus available capacity is more than sufficient to offset the loss of Iranian exports, currently averaging about 1.8 million b/d. Spot prices, however, could begin to rise if buyers anticipated a further spread of the conflict.

If Khark Island were shut down and Tehran retaliated by severing the Iraqi pipeline and knocking out Kuwaiti exports, a total of nearly 5 million b/d of export capacity would be lost. Although other countries could replace these lost supplies by raising output, this would eliminate much of the surplus capacity available to the market and leave oil importing countries in a high risk situation. The uncertainties surrounding the duration of the disruption and the fear of a much more serious shortage resulting from a cutoff of Saudi exports would cause spot prices to rise. As long as Saudi export capabilities remain intact, however, oil supplies should be adequate to meet winter consumption requirements. On the other hand, the loss of Saudi Persian Gulf export potential alone would reduce available export capacity by as much as 6 million b/d.

Under a worst case scenario involving the interruption of oil flows through the Iraq-Turkey pipeline and the cutoff of all Persian Gulf oil exports, 14 million b/d in Persian Gulf productive capacity would be lost to the market. Denial of access to Persian Gulf oil supplies for a prolonged period would cause a 3-4 million b/d net supply shortfall, almost double the size of the shortage caused by the Iranian Revolution in 1979. Under these circumstances, prices would rise sharply and the economic recovery would be interrupted. We estimate oil prices could rise by about \$5-10 per barrel for each 1 million b/d net supply shortfall. Furthermore, under this worst case scenario the real GNP growth rate could be reduced by up to 2 percentage points.

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Implications for the United States

The United States has a large stake in the continued flow of oil from the Persian Gulf in spite of the fact that US oil imports from the Gulf are less than 200,000 b/d. Although the United States could draw on non-Gulf surplus capacity to cover a loss in Persian Gulf imports, it probably would be required to share the burden of any OECD net supply shortfall either through informal company redistribution or the IEA allocation system. The IEA sharing plan can be triggered when the shortfall faced by a member country or the group reaches a minimum of 7 percent.

Effective deployment of government-owned stocks under the terms of the IEA agreement would play an important role in offsetting any future oil supply disruption. The key players in any coordinated strategic stock drawdown would be the United States, Japan, and West Germany. The major problem would be the design and implementation of a program believed to be effective and equitable. In addition to demand restraint measures, countries without government-owned stockpiles could share the burden of a disruption by augmenting supplies through a relaxation of mandatory commercial stockpile requirements.

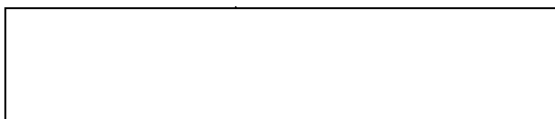
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Non-Communist Oil Supplies*
First Half 1985

(million b/d)

	<u>Available Capacity</u>	<u>Current Production</u>	<u>Surplus Capacity</u>
Persian Gulf:	<u>17.5</u>	<u>10.0</u>	<u>7.5</u>
Saudi Arabia	8.5	3.4	5.1
Iran	3.3	2.4	0.9
Iraq	1.4	1.3	0.1
Kuwait	1.3	0.9	0.4
UAE	1.8	1.3	0.6
Other	1.2	0.8	0.4
Non-Persian Gulf:	<u>37.2</u>	<u>34.1</u>	<u>3.2</u>
Indonesia	1.8	1.3	0.4
Libya	1.9	1.1	0.8
Nigeria	2.2	1.5	0.7
Venezuela	2.3	1.7	0.7
Algeria	1.2	1.1	0.1
Other	27.8	27.4	0.5
Total Supply:	54.8	44.1	10.7



*Includes NGLs. Totals may not add due to rounding.